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FTC v. THE PETROLEUM INDUSTRY: THE NEED FOR CONSISTENT REGULATORY POLICY

INTRODUCTION

On July 18, 1973, the Federal Trade Commission issued a complaint¹ against the nation's eight largest petroleum companies alleging three separate violations of section five of the Federal Trade Commission Act.² Complaint counsel's contemplated relief includes the divestiture of 40 percent to 60 percent of respondents' refinery capacity in the relevant market and some of respondents' pipeline assets.³ Given the vital importance of petroleum products to our society⁴ and the recent outpouring of criticism against the petroleum industry, the FTC's investigation and its subsequent complaint were not entirely unexpected.⁵ However, the comprehensive reach of the remedy proffered by complaint counsel, the restructuring of the petroleum industry, if successful, presages profound repercussions not only for that

1. Complaint, Exxon Corp., No. 8934 (F.T.C., July 18, 1973) [hereinafter cited as Complaint]. Respondents include Exxon Corporation, Texaco Incorporated, Gulf Oil Corporation, Mobil Oil Corporation, Standard Oil Company of California, Standard Oil Company (Indiana), Shell Oil Corporation, and Atlantic Richfield Company. After filing the complaint, the FTC filed its discovery plans, but only nine depositions had been taken by late 1974. The FTC has urged appointment of an administrative law judge for the purpose of completing discovery by all parties no later than October, 1977, and is hoping for a 1978 trial date. ANTITRUST & TRADE REG. REP. No. 685, at A-1 (1974).

2. 15 U.S.C. § 45(a) (1970) provides in part: "Unfair methods of competition in commerce, and unfair or deceptive acts or practices in commerce, are declared unlawful."

3. See Prediscovery Statement for Complaint Counsel at 137-41, Exxon Corp., No. 8934 (F.T.C., July 18, 1973) [hereinafter cited as Prediscovery Statement]. Complaint counsel seeks additional remedial measures including a ban against future refinery acquisitions and limits on joint ventures, processing arrangements and crude and product exchanges. It should be noted that the relief of divestiture was not included in the complaint, which merely requested that "the Commission [be able to] order such relief as is necessary or appropriate in order to correct or remedy the effects of anti-competitive practices . . ." Complaint, *supra* note 1, at 13.

4. Since 1950, energy consumption in the United States has more than doubled, with petroleum and natural gas now accounting for approximately 70 percent of our energy supply. FTC, PRELIMINARY FEDERAL TRADE COMMISSION STAFF REPORT ON ITS INVESTIGATION OF THE PETROLEUM INDUSTRY 1 (1973) (reprinted by Senate Committee on Interior and Insular Affairs) [hereinafter cited as PRELIMINARY STAFF REPORT].

5. *Id.* at V-XI. Brief of Points and Authorities for Exxon Corporation in Support of Motions to Dismiss at 3-12, Exxon Corp., No. 8934 (F.T.C., July 18, 1973).

industry, but for the structure and behavior of much of America's industrial activity.

The request for fundamental structural relief appears to be a reaction to the FTC's staff evaluation of its prior antitrust litigation:

The history of the Federal Trade Commission's activity in the petroleum industry has been characterized by a case-by-case attack on specific anti-competitive marketing practices. . . . Despite the staff's success . . . the petroleum industry over the last 50 years has managed to circumvent the orders in many cases by subtle changes in policy or practices.

[T]he practice-by-practice approach to antitrust attack, which sought to correct specific anti-competitive conduct at the marketing level, did not adequately address the industry's vertically integrated structure or its multi-level behavior. . . . To fashion a remedy for one level without considering the performance of a company, or the industry, at the other levels, ignores the market power associated with vertical integration and limited competition.⁶

In developing a remedy for its present action complaint counsel, therefore, sought to "carefully choose remedies which will alleviate its (the industry's) underlying competitive deficiencies."⁷

If the elimination of competitive deficiencies is complaint counsel's principal objective,⁸ the threshold question which arises is whether this objective can be achieved through structural reorganization. While respondents may have contributed to any alleged behavioral or structural competitive deficiencies in the oil industry, there are persuasive arguments that governmental regulation of the industry is primarily responsible for engendering and maintaining these underlying deficiencies. More importantly, it appears likely that the con-

6. PRELIMINARY STAFF REPORT, *supra* note 4, at 4-5.

7. Prediscovery Statement, *supra* note 3, at 137.

8. Since section five of the Federal Trade Commission Act is prophylactic or corrective rather than punitive, particular attention should be given to the probable social benefits or costs of any contemplated relief. Section 45 of the Act, 15 U.S.C. § 45 (1970), provides in pertinent part:

(b) Whenever the Commission shall have reason to believe that any such person . . . is using any unfair method of competition or unfair or deceptive act or practice in commerce . . . it shall issue and serve . . . a complaint stating its charges in that respect and containing a notice of a hearing If upon such hearing the Commission shall be of the opinion that the method of competition or the act or practice in question is prohibited by sections 41 to 46 and 47 to 58 of this title, it shall make a report . . . and cause to be served . . . an order requiring such person . . . to cease and desist from using such method of competition or such act or practice.

tinuation of the same governmental policies will preclude any probable benefits which might otherwise accrue from restructuring the industry. To paraphrase the FTC's staff evaluation: to fashion a remedy for the industry, without considering the regulatory context within which such restructuring must function, is to ignore a fundamental determinant of market behavior and structure. It is the purpose of this Comment to explore the interrelationship between complaint counsel's proposed divestiture and current governmental interference in the industry's markets. Specifically, the author will attempt to explain why structural change, without accompanying regulatory changes, cannot be expected, in the long run, to effectuate ameliorative structural or behavioral modifications. The industry's present structure and respondents' alleged violations will first be examined. The influence of market demand prorationing, import restrictions, and special tax provisions on the industry's structure and conduct will then be considered. The Comment will conclude by discussing why divestiture is not likely to achieve the objectives desired by the FTC, should existing governmental policies remain constant.

I. PETROLEUM INDUSTRY STRUCTURE AND THE FTC COMPLAINT

On May 31, 1973, Senator Henry Jackson forwarded a letter to the FTC requesting the preparation of a report on the petroleum industry.⁹ On July 6, 1973, the FTC submitted a preliminary staff report on its investigation of the industry.¹⁰ For purposes of its investigation the FTC divided the petroleum industry into four functionally distinct levels: crude oil production, refining, marketing, and transportation.¹¹ While noting that significant numbers of independent companies operate at each level, the FTC has charged that the industry is dominated by 18 vertically integrated firms ("majors") that operate at all levels,¹² the eight largest of which were named in its complaint.

At the crude oil production level there were between 10,000 and 12,000 producers in the United States in 1969, but the top eight accounted for approximately 51 percent of domestic net crude produc-

9. PRELIMINARY STAFF REPORT, *supra* note 4, at V-VIII.

10. *Id.* at IX.

11. *Id.* at 12. However, in its prediscovery statement complaint counsel further separated product transportation and crude oil transportation, making five levels. *See* Prediscovery Statement, *supra* note 3, at 1.

12. PRELIMINARY STAFF REPORT, *supra* note 4, at 12.

tion.¹³ The FTC, comparing domestic net crude production in 1960, noted a clear trend toward increasing concentration at this level.¹⁴

The refining level, which the FTC views as pivotal to the alleged anticompetitive structure and behavior of the industry, was composed of 282 domestic refineries and approximately 129 refining companies in 1972.¹⁵ However, the top eight firms possessed approximately 58 percent of domestic crude oil and gasoline refining capacity in 1970.¹⁶ Within the relevant market the respondents accounted for 65 percent of refining capacity.¹⁷ Perhaps more importantly, the domestic self-sufficiency rate of the top eight refiners averaged approximately 68 percent in 1969.¹⁸ Independent refiners enjoyed a self-sufficiency rate of under 5 percent in 1970, relying for approximately 31 and 17 percent of their crude needs respectively from the top eight producers and the ten next largest "majors."¹⁹

Gasoline marketing was found to be the most competitive level of the petroleum industry with major branded gasoline stations and independent stations engaging in significant price competition.²⁰ The

13. *Id.* at 12-13. The top 4 and 20 oil producing firms accounted respectively for 31 and 70 percent of domestic crude production. It should be noted that the statistics used in this Comment often do not correspond precisely to the relevant geographic market because the FTC's data are either national or divided according to PAD (Petroleum Administration for Defense) districts, while the relevant geographic market includes PAD districts I & III plus Tennessee. Furthermore, the FTC's data are by no means incontrovertible. As it admitted in its statement on methodology, data were received from only some 50 cooperating firms in addition to public and governmental sources and some federal and state agencies. *See id.* at 5-6. However, since this Comment is critical of the FTC's proposed divestiture, should governmental regulation of the industry remain constant, it has accepted the agency's data for purposes of analysis.

14. *Id.* The top 4, 8, and 20 oil producing companies in 1960 accounted respectively for 26, 43, and 62 percent of domestic net crude production.

15. *Id.* at 18.

16. *Id.* The top 4 and 20 oil refining companies possessed respectively approximately 33 and 86 percent of domestic crude oil and gasoline refining capacity.

17. Perdiscovery Statement, *supra* note 3, at 9.

18. PRELIMINARY STAFF REPORT, *supra* note 4, at 20-21. The self-sufficiency rate equals the percentage of crude inputs acquired by a refiner from owned production facilities. World wide self-sufficiency of the top eight refiners averaged over 100 percent in 1969.

19. *Id.* at 6-7. The low self-sufficiency rate of independent refiners is particularly significant in periods of short supply, when they are vulnerable to the marketing decisions of the majors who normally provide almost one half of the independents' inputs. Independent refiners' shortages in turn become the shortages of independent marketers of gasoline.

20. *Id.* at 21-23. Independents tend to distinguish their product primarily on a price basis, while major branded stations tend to engage in product differentiation. Where consumers show a preference for price differentiation, vigorous price competition between majors and independents may result.

top eight marketers of gasoline (respondents) accounted for approximately 55 percent of the 1970 market share.²¹ Approximately 75 percent of crude oil and 27 percent of refinery products were transported by pipelines which are regulated as "common carriers" by the Interstate Commerce Commission.²² Because of high capital costs and large economies of scale, the pipeline level is dominated by the major petroleum companies individually or through joint ventures.²³

In its complaint the FTC has alleged three separate violations of section five of the Federal Trade Commission Act. The complaint charges that respondents' acts and practices:

20. [C]onstitute a combination or agreement to monopolize refining of crude oil into petroleum products in the relevant markets

2. . . . [M]aintained monopoly power over the refining of crude oil into petroleum products in the relevant markets

3. . . . [R]estrained trade and maintained a noncompetitive market structure in the refining of crude oil into petroleum products in the relevant markets²⁴

Complaint counsel construed the first two alleged violations as Sherman Act related charges.²⁵ Noting that a Sherman Act violation is not prerequisite to proof of a section five violation,²⁶ complaint counsel nonetheless has used Sherman criteria to structure its arguments.²⁷

21. *Id.* The top 4 and 20 gasoline marketing firms controlled respectively 31 and 79 percent of the gasoline market.

22. *Id.* at 23.

23. *Id.*

24. Complaint, *supra* note 1, at §§ 20-22.

25. Prediscovery Statement, *supra* note 3, at 96-99; *see* Sherman Antitrust Act, §§ 1, 2, 15 U.S.C. §§ 1, 2 (1970).

26. Unfair methods of competition condemned by section five are not confined to those acts and practices which were unlawful at common law, or that were condemned by the Sherman or Clayton Acts. Rather, section five was intended to reach, in their incipency, acts and practices which, if full blown, would violate those acts. *See* FTC v. Brown Shoe Co., 384 U.S. 316, 320-21 (1966); FTC v. Motion Picture Advertising Serv. Co., 344 U.S. 392, 394-95 (1953); FTC v. Cement Institute, 333 U.S. 683, 693 (1948).

27. However, it is unclear whether complaint counsel is arguing a violation of section one or section two of the Sherman Act. The language of the first alleged violation, "a combination or agreement to monopolize," might be construed either as a combination in restraint of trade under section one, or as a combination or conspiracy to monopolize under section two. The second alleged violation, that respondents "maintained monopoly power," appears to fall within the "shall monopolize" language of section two. Such a violation would require proof of monopoly power and the willful

The third alleged violation is not a Sherman Act related charge, but is premised on the FTC's power to prevent unfair competitive practices. For purposes of the complaint, the relevant geographic market encompasses the Eastern and Gulf states, part of the Mid-Continent area, and relevant submarkets.²⁸ The product market is the "refining of crude oil into petroleum products."²⁹

Underlying the alleged violations is the FTC's accusation that the respondents' conduct has been cooperative rather than competitive. In addition to charging specific acts in violation of section five, the FTC points to an "intricate web of interrelationships" among the respondents which promotes common rather than competitive interests:³⁰ joint ventures in crude oil production and pipeline transportation of crude,³¹ common ownership of respondent companies,³² and indirect connections through interrelations with the financial community.³³ The FTC further alleges³⁴ that at the marketing level respondents, pursuing a common course of action, have refused to sell gasoline and other refined products to independent marketers, have participated in restrictive or exclusionary exchanges and sales of gasoline and other refined products, and have entered into processing arrangements with independent refineries in order to avoid competition by limiting the availability of refined products to independent marketers.³⁵ The FTC also charges that at the crude and

acquisition or maintenance of that power, as opposed to mere economic inevitability. See *United States v. E. I. du Pont de Nemours & Co.*, 351 U.S. 377 (1956) (cellophane case); *United States v. Griffith*, 334 U.S. 100 (1948); *American Tobacco Co. v. United States*, 328 U.S. 781 (1946); *United States v. Aluminum Co. of America*, 148 F.2d 416 (2d Cir. 1945); *United States v. United Shoe Machinery Corp.*, 110 F. Supp. 295 (D. Mass. 1953).

28. The relevant geographic market consists of Petroleum Administration for Defense (PAD) districts I & III and Tennessee. Prediscovery Statement, *supra* note 3, at 32.

29. Complaint, *supra* note 1, at §§ 11-12. The principal submarket is the refined product, gasoline. Prediscovery Statement, *supra* note 3, at 35.

30. Prediscovery Statement, *supra* note 3, at 3-6.

31. *Id.* at 23-29.

32. *Id.* at 5-6. For example, complaint counsel notes that Chase Manhattan Bank is both the largest shareholder of Atlantic Richfield and the second largest shareholder of Mobil.

33. *Id.* at 29-30.

34. Complaint counsel does not specify which of the alleged facts support which of the alleged section five violations. For the list of allegations, see Complaint, *supra* note 1, at §§ 15-19; Prediscovery Statement, *supra* note 3, at 102-07.

35. The FTC alleges that because of the 1973 oil shortage 1,200 gas stations had closed, due to a lack of product, by May 30, 1973. All but a handful were independents. PRELIMINARY STAFF REPORT, *supra* note 4, at 1.

refining levels respondents have participated in restrictive or exclusionary transfers of crude among themselves, have adhered to a system of posted prices to maintain an artificially high level of crude prices, and have accommodated the needs of each other in the transportation of crude through their ownership and control of transporting facilities. The effect of these alleged practices, according to the FTC, has been to increase barriers to entry by keeping profits at the refining level artificially low and limiting the supply of crude oil available to independent refiners and potential entrants.³⁶ The FTC charges that respondents' acts and practices have foreclosed actual and potential competition at all levels of the petroleum industry, have distorted the normal response of supply and demand for refined products, and have caused profits and returns on investment substantially in excess of those that would have been earned in a competitively structured market.³⁷

Even if these allegations are eventually substantiated, it is still necessary to determine the extent to which state and federal intervention in the market mechanism has encouraged or even compelled non-competitive industry structure and conduct. This determination is fundamental to an evaluation of whether such intervention will preclude the otherwise purported competitive advantage of restructuring the petroleum industry. To understand the probable impact governmental policies portend for the future, it is helpful first to examine the influence they have had in the past.

II. GOVERNMENTAL INTERVENTION IN THE MARKET MECHANISM

A. *State Restrictions on the Domestic Production of Crude*

In response to high oil prices and shortages at the end of World War I, the number of wells drilled in the United States increased from 14,157 in 1915 to 33,911 in 1920.³⁸ After the East Texas Field was tapped in 1930 posted prices plummeted to 18 cents a barrel

36. The FTC charges that despite an increase in gasoline consumption of approximately 60 percent over the past 15 years there has not been one new entrant of significant size during this period. *Id.*

37. Prediscovery Statement, *supra* note 3, at 107.

38. M. DE CHAZEAU & A. KAHN, *INTEGRATION AND COMPETITION IN THE PETROLEUM INDUSTRY* 137 (1959) [hereinafter cited as DE CHAZEAU].

in July 1931, as compared to an average 1920 Oklahoma-Kansas posted price of over \$3.00 per barrel.³⁹ In response to growing capacity and depressed prices, the oil producing states began to develop methods of restricting intrastate production. These state prorationing regulations were reinforced by congressional passage of the Connally Hot Oil Act⁴⁰ which prohibited interstate commerce in oil and oil products produced in violation of state law.

Market demand prorationing attempts to limit production in two fundamental ways.⁴¹ First, it prevents any well from producing beyond its physical "Maximum Efficient Rate" (MER).⁴² Second, it attempts to limit future production of crude oil to anticipated market demand at prevailing prices, and to prorate such production ("allowables")⁴³ among fields and wells in a manner calculated to preserve equity among producers and prevent any well from producing beyond its MER.⁴⁴ While prorationing has prevented physically wasteful production in excess of MER and protected correlative rights of small and independent owners in an oil reservoir,⁴⁵ its critics have argued that this regulatory mechanism has generated higher crude oil prices and a misallocation of resources.

One of the principal criticisms of market demand prorationing has been that, by limiting supply to anticipated demand at prevailing prices, prices are maintained by administrative action, rather than determined by competitive adjustment to costs. In effect, the system implements the price and import policies of the large integrated firms since their price leadership would diminish without the sympathetic cooperation of the state regulatory commissions.⁴⁶ While the number

39. *Id.* at 138-41.

40. 15 U.S.C. § 715 (1970).

41. Texas, Louisiana, Oklahoma, New Mexico and Kansas, which together accounted for approximately 74 percent of domestic crude production in 1970, use prorationing. Texas alone accounted for approximately 36 percent. PRELIMINARY STAFF REPORT, *supra* note 4, at 16.

42. "MER" is an engineering-geological determination of the theoretically maximum rate of flow of crude oil which will not endanger ultimate recovery from the pool by a too rapid release of underground pressures.

43. "Allowables" represent the number of calendar days of permitted MER production per month. Texas, Louisiana, New Mexico and Kansas permitted 100 percent "allowables" of MER after the 1973 oil shortage. PRELIMINARY STAFF REPORT, *supra* note 4, at 16.

44. *See* DE CHAZEAU, *supra* note 38, at 122-23.

45. *Id.* at 124-25.

46. *Id.* at 125, 239, 559.

and direction of price changes fluctuated significantly between 1920 and 1934, after the institution of more effective prorationing, there occurred a steady increase in posted crude prices between 1934 and 1957 with only one minor exception.⁴⁷ To the degree that prices are artificially supported, a significant redistribution of income from consumers to producers occurs.

More importantly, critics have argued that by viewing conservation as the prevention of geological waste, society is not assuring an optimal allocation of its scarce resources over time.⁴⁸ A number of commentators have argued that conservation of oil must be viewed economically: "that manner of recovery and distribution of use over time which maximizes the present value of oil resources to society, expected future net proceeds from them being discounted at the prevailing rate of interest."⁴⁹ In other words, maximizing present net value of a stream of income flowing over time from the exploitation of oil is analogous to the planning of an investment, which also involves the balancing of costs against future income. Under such a perspective physical conservation (the avoidance of physical loss of potential supply, regardless of cost) does not make economic sense when added opportunity costs of scarce resources required by a slower rate of recovery exceed the added present value of the additional oil to be gained. There must be an economic balancing of future benefits against the present costs to society of a slower rate of use.

Further, by allocating a pro rata share to high cost stripper wells and limiting production from the more efficient non-stripper wells, the cost of oil per barrel is increased.⁵⁰ Prorationing has also failed to prevent excessive drilling,⁵¹ which results in overcapitalization as

47. *Id.* at 138, 148-49. As an example of prorationing's response to market supply, when gasoline stocks were disturbingly high to the industry in late 1956, the Texas commission limited allowables to nine days in March 1957, and eight days in April 1957. *Id.* at 557-58. For a general discussion of the adjustment of allowables in response to supply, see *id.* at 146-66.

48. See Davidson, *Public Policy Problems of the Domestic Crude Oil Industry*, 53 AM. ECON. REV. 85 (1963); McDonald, *Unit Operation of Oil Reservoirs as an Instrument of Conservation*, 49 NOTRE DAME LAW. 305 (1973).

49. McDonald, *supra* note 48, at 308-09; see DE CHAZEAU, *supra* note 38, at 230-56.

50. The average and marginal costs of stripper wells (those wells employing methods of secondary recovery with reinjection of either water or dry gas into the field) are much higher than those of nonstrippers. See Davidson, *supra* note 48, at 88-89.

51. DE CHAZEAU, *supra* note 38, at 124.

well as the deletion of original gas and water drives thereby increasing the costs of secondary recovery. To the extent that additional resources have been allocated to the production of a supply of crude oil which, but for prorationing, might have been produced less expensively, a significant misallocation of resources and lower standard of living have been generated.

While prorationing has been severely criticized, some type of intervention in the market mechanism at the crude production level appears desirable. Inherent in limited raw materials are "user costs," that is, part of the present cost is the loss of future higher prices. Over time, therefore, the producer will attempt to push production to the point where the incremental sacrifice of current net proceeds equals the incremental discounted value of expected future net proceeds. However, in oil, a producer's cost may differ substantially from those of society. Where competing producers draw from the same pool, the "rule of capture" applies: a producer will tend to bring to the surface as much crude as quickly as possible since the sacrifice of future net proceeds due to the loss of otherwise recoverable oil is offset by the gain of current net proceeds that stems from currently producing oil at the expense of neighbors. Without regulation, producers will tend to produce too rapidly to maximize benefits to society.⁵²

Another problem arises because the crude oil production industry is characterized by high fixed costs with variable lifting costs representing a relatively small percentage of total crude oil costs.⁵³ Because of the "rule of capture" and low variable lifting costs, the supply of oil tends to be inelastic. Since the short run demand for oil is also relatively inelastic,⁵⁴ a precipitous price decline may follow a non-regulated major discovery. Without regulation, the major supply of crude oil offered to the market may reflect neither the level of

52. In other words, if a producer of a common reservoir cannot be assured that the oil he is leaving for future sale will remain there, he will tend to increase his current output, even though this increase will lower the maximum return he might otherwise realize, were he assured that his neighbors would not increase their current production at his expense. Since the producer is not earning the maximum return available over time, it may be concluded that there is a misallocation of the resource between current and future periods. See generally Davidson, *supra* note 48, at 94-95; McDonald, *supra* note 48, 308-10.

53. DE CHAZEAU, *supra* note 38, at 66.

54. *Id.* at 152.

demand nor the level of costs, but rather the chance of discovery. This situation may be socially undesirable since it may lead to alternating periods of glut and dearth.⁵⁵

The most widely propounded alternative to prorationing has been federally mandated unitization.⁵⁶ Unitization would be required where there are separate property interests in the oil to be produced from a common reservoir. Both the costs of development and production, as well as the proceeds, would be shared ratably by the owners. Single control over a single field would preclude the economic waste inherent in the "rule of capture," as well as permit economic self-interest to determine well spacing and secondary recovery.⁵⁷ Production would increase only if the gain in current net proceeds exceeds the sacrifice of discounted future net proceeds. Profit maximization would therefore be more commensurate with maximizing benefits to society. Competitive pressures, with minimal governmental interference, would replace state regulation which has caused a significant redistribution of income and misallocation of resources.

B. Federal Restrictions on Foreign Oil Imports

From being a net exporter of crude oil in 1938, the United States was importing over 15 percent of its crude oil and products consumption by 1959.⁵⁸ This steady increase of oil imports raised fears of dependence on foreign sources and threatened domestic producers who had previously been relatively protected from excess domestic supply and falling prices by state market demand prorationing.

55. See Davidson, *supra* note 48, at 95-96.

56. See DE CHAZEAU, *supra* note 38, at 240; Davidson, *supra* note 48, at 97-98; McDonald, *supra* note 48, at 311-16.

57. The field, by operating as a single unit, would permit the manager to maximize profits by leaving optimal amounts of oil in the ground for future recovery, without fear that those supplies would be taken by neighboring producers. Two of the major problems of mandatory unitization would be the states' probable opposition to the surrender of authority and possible industry fear of federal control. A more substantive problem involves the inability to determine precisely the limits of a reservoir and, consequently, who should or should not become a member of a particular cooperative group. Further, widespread common ownership interests, coupled with the relative price inelasticity of demand for crude oil, might encourage restriction of production and higher prices. However, any tendency toward higher prices and underutilization of productive capacity seems significantly stronger under market demand prorationing than unitization. See DE CHAZEAU, *supra* note 38, at 240-44.

58. J. BURROWS & T. DOMENCICH, AN ANALYSIS OF THE UNITED STATES OIL IMPORT QUOTA 2-5 (1970).

In 1955, the President was empowered by Congress to authorize increased restrictions on those imports threatening to impair the national security.⁵⁹ In response to rising oil imports and the failure of the Voluntary Oil Import Program of 1957 to effectively restrict such imports, President Eisenhower issued a presidential proclamation in March 1959, imposing mandatory oil import controls.⁶⁰ After 14 years of mandatory controls, President Nixon amended Proclamation 3279 and provided for the gradual transition from a quota method of adjusting imports to the suspension of existing tariffs and the implementation of a system of fees.⁶¹

Despite the current absence of mandatory import quotas, the recent Middle East oil embargo and the high world oil price, which have seriously affected the United States balance of payments deficit, have caused President Ford to seek reinstatement of a restrictive oil import policy.⁶² More importantly, the high price of foreign oil is causing increased development of new high-cost domestic energy sources. As the ability of major consuming countries to produce their own in-

59. Trade Agreements Extension Act of 1955, ch. 169, §§ 1-7, 69 Stat. 162. Section two of the Trade Agreements Extension Act of 1954, ch. 445, §§ 1-3, 68 Stat. 360, had only prohibited decreases in the duty on an article if such reduction would threaten domestic production needed for national defense. Section 232 of the Trade Expansion Act of 1962, 19 U.S.C. § 1862 (1970), permits even broader presidential latitude in determining and dealing with imports which impair national security. The Act provides in part that the Director of the Office of Emergency Preparedness shall advise the President of an article being imported into the United States in such quantities or under such circumstances as to threaten to impair the national security. The President may then "take such action, and for such time, as he deems necessary to adjust the imports of such article and its derivatives so that such imports will not so threaten to impair the national security." The Act provides that consideration should be given to domestic production needed for projected national defense requirements as well as to the impact of foreign competition on the economic welfare of individual domestic industries.

60. Presidential Proclamation 3279, 24 Fed. Reg. 1781 (1959), *as amended*, 3 CFR 31 (1974). It is interesting to note that while the President felt compelled, for national security reasons, to restrict oil imports, there was no modification of those special tax provisions (such as percentage depletion) available to foreign operations of domestic firms. While restricting imports, and thereby increasing prices, the government continued to subsidize foreign production.

61. Presidential Proclamation 4210, 38 Fed. Reg. 9645 (1973).

62. On February 1, 1975, President Ford imposed a \$1 per barrel levy on imported oil in order to cut domestic consumption by increasing prices. The President has ordered levies totalling \$3 per barrel by April 1, 1975, N.Y. Times, Feb. 2, 1975, § 4 (The Week in Review), at 1, col. 3. The United States reported a \$3 billion trade deficit for 1974. If world oil prices had been the same as in 1973, there would have been a \$14 billion surplus. *Id.* at 4, col. 1.

cremental energy supplies increases, the world oil price will tend to fall to a level no higher than the cost of energy from those alternatives. Should the world price of oil again fall below United States domestic prices (since the average real extraction cost of foreign oil will be considerably lower),⁶³ consumer interests are likely to pressure for access to the cheaper imports, to the disadvantage of high-cost domestic producers. The prevention of either of two undesirable extremes—overcapitalization in high-cost energy sources or underprotection of developing high-cost domestic sources—will probably require continuing governmental interference in the market mechanism of a resource that is vital to our national security.⁶⁴ It therefore remains pertinent to understand the past consequences of such policies, as well as what their reinstatement portends for the structure and conduct of the petroleum industry.

The Mandatory Oil Import Program had three principal functions: (1) regulating the degree of import restrictions through quota levels, (2) allocating permitted imports among domestic claimants, and (3) managing program administration. Under the program, quota levels of imported petroleum varied both by product and geographic divisions.⁶⁵ Licenses or "tickets" to import crude and unfinished oils were allocated to refiners as a percentage of refinery inputs. However, small refineries could receive a larger than pro rata share of permitted imports, as could refineries with historically higher percentages of imported inputs.⁶⁶

63. STAFF OF SENATE COMM. ON FINANCE, 93D CONG., 1ST SESS., *FISCAL POLICY AND THE ENERGY CRISIS* 30 (Comm. Print 1973).

64. Tussing, *Prices, Profits and Protectionism—Energy Issues of the 1970's*, in STAFF OF SENATE COMM. ON INTERIOR AND INSULAR AFFAIRS, 93D CONG., 2D SESS., *ENERGY POLICY PAPERS* 119, 130-34 (Comm. Print 1974).

65. The United States was divided into five administrative districts plus Puerto Rico. Petroleum imports were classified as (1) crude, (2) unfinished oils, (3) finished products, and (4) residual fuel oil to be used as fuel. See CABINET TASK FORCE ON OIL IMPORT CONTROLS, *THE OIL IMPORT QUESTION* ¶¶ 117-127 (1970); Comment, *The Mandatory Oil Import Program*, 7 TEXAS INT. L.J. 373 (1972); 3 N.Y.U.J. INT'L L. & POL. 343 (1970).

66. The "sliding scale" method of allocation discriminated in favor of smaller and newer refineries by providing that the greater the volume of inputs the greater the total allocation but the smaller the allocation as a percentage of total refinery inputs. The "historical minimum" method assured that established companies did not suffer drastic reductions after implementation of the quota, by permitting up to 80 percent of the last allocation received under the Voluntary Oil Import Program of 1957. See Cicchetti & Gillen, *The Mandatory Oil Import Quota Program*, 13 NATURAL RESOURCES J. 399, 403-04 (1973).

Proponents of the program argued that permitting larger imports of cheaper foreign oil would result in lowered United States productivity and increased dependence on foreign oil sources.⁶⁷ Opponents argued that the program had developed discriminatory allocations,⁶⁸ and was either an unnecessary or an inefficient method of meeting national security objectives. In 1970 the Cabinet Task Force on Oil Import Control issued a report on the relationship of oil imports to the national security.⁶⁹ The majority estimated that the "cost" of import restrictions, to consumers and to the nation as a whole, was approximately \$5 billion per year.⁷⁰

The report recommended a phased transition to a tariff system and intensive study of the feasibility of developing safeguards for United States oil security by means other than import controls.⁷¹ Of course, the present high world price of foreign oil significantly alters the relevance of many of the findings of the Cabinet Task Force. However, as discussed above, those prices may again equal or fall below domestic prices. Should policy mandate further restrictions on oil imports for national security reasons, those programs which minimize the social costs of such restrictions and are conducive to promoting competition within the industry should be favored. As previously implemented, import quotas would therefore still appear to be less desirable than the more flexible tariff system proposed by the Cabinet Task Force.

67. See 3 N.Y.U.J. INT'L L. & POL. 343, 347-50 (1970).

68. There were special provisions relating to overland shipments from Mexico and Canada. There were yearly negotiations between the petrochemical industry and government officials for direct allocations as a percentage of petrochemical feedstocks. There were privately negotiated settlements between particular petroleum companies and the Department of the Interior, permitting increased imports by specific companies in return for substantial capital investment in Puerto Rico and the Virgin Islands. See Cicchetti & Gillen, *supra* note 66, at 404-07.

69. CABINET TASK FORCE ON OIL IMPORT CONTROLS, THE OIL IMPORT QUESTION (1970). It should be remembered that statutory authority for presidential restrictions of oil imports is limited to those articles which threaten to impair the national security. See note 59 *supra*.

70. This "cost" was made up of approximately 3.0-3.5 billion dollars per year of transfer payments from one sector of the economy to another, plus efficiency losses in production and transportation of about 1.5-2.0 billion dollars per year. See CABINET TASK FORCE ON OIL IMPORT CONTROLS, THE OIL IMPORT QUESTION ¶¶ 207-08 (1970).

71. *Id.* at ¶¶ 432-37. The report suggested investigation of the following security alternatives: underground and conventional storage; subsidization of shale oil or coal oil capacity; and development of emergency capacity in Naval Petroleum Reserve No. four.

C. Special Tax Provisions Available to the Petroleum Industry

The petroleum industry presently enjoys distinctive tax treatment⁷² which is particularly advantageous to the large integrated firms. The most controversial provision available to the industry is the percentage depletion allowance.⁷³

The principal distinction between depletion and depreciation is that total depreciation deductions never exceed the original cost of the asset. On the other hand, percentage depletion is not related to the cost of the asset, but permits a producing firm to subtract from its gross income before taxes an amount equal to 22 percent of total revenues from the property. It is taken when it exceeds cost depletion,⁷⁴ but the deduction may not exceed 50 percent of the taxable income from the property.⁷⁵ Since percentage depletion is not limited to the original cost of the asset, the cost may be recovered many times over.

Crude oil producers may also depreciate under regular tax methods, or write off at a cost depletion rate, certain tangible equipment attached to a well.⁷⁶ Certain intangible expenses incurred in bringing a well into production may be either capitalized and depreciated over the useful life, or deducted currently.⁷⁷ Further, the costs of dry holes may be expensed, or may be capitalized.⁷⁸

These special tax provisions permit crude oil producers to accelerate deductions and thereby defer taxes, as well as to enjoy deductions beyond the recovery of costs and thus reduce taxes. Large, foreign-producing domestic firms have been further benefited by being

72. On February 28, 1975, the House of Representatives voted 248 to 163 to repeal the oil depletion allowance. The provision was part of a 21.3 billion dollar antirecession tax cut bill. *New York Times*, February 28, 1975, at 1, col. 1.

73. INT. REV. CODE OF 1954, §§ 613-14.

74. Cost depletion is a unit-of-production method based on the cost of the property. Percentage depletion reduces the remaining basis of cost depletion. When the adjusted basis reaches zero, cost depletion ceases.

75. See STAFF OF SENATE COMM. ON INTERIOR AND INSULAR AFFAIRS, 93D CONG. 2D SESS., AN ANALYSIS OF THE FEDERAL TAX TREATMENT OF OIL AND GAS AND SOME POLICY ALTERNATIVES 1-4 (Comm. Print 1974).

76. *Id.* at 3. Such tangible equipment would include pumps and other accessories attached to the well.

77. *Id.* at 4. Intangible drilling costs include expenses incurred in bringing a well into production such as labor, materials, supplies and repairs. Viewed economically, they are part of the cost of an income producing asset and should be recovered as cost depletion.

78. *Id.* Economically, the costs of drilling dry holes are part of the capital cost of the producing well. Expensing permits a producer to write off a large percentage of the capital costs in the first year.

granted a dollar for dollar reduction of United States taxes for "royalties" paid to foreign governments.⁷⁹

The principal criticism of the distinctive tax treatment enjoyed by the petroleum industry focuses on percentage depletion. Proponents of percentage depletion argue that, due to the high risk of crude oil exploration, percentage depletion eliminates the adverse effects of the corporate income tax on resource allocation and therefore merely restores tax neutrality.⁸⁰ However, a majority of commentators argue that available empirical evidence suggests that percentage depletion is more than neutralizing. The resulting higher after-tax rates of return attract to the petroleum industry resources that would have been more productive in an alternative location.⁸¹

In response to the argument that percentage depletion is a necessary incentive to secure sufficient exploration, critics argue that there is considerable doubt whether percentage depletion efficiently converts tax revenue losses into increased domestic capacity to produce crude oil.⁸² The CONSAD Research Corp. report⁸³ estimated that over 40 percent of percentage depletion went to nonoperating interests and foreign production of domestic firms, and thus had little or no effect on increasing domestic reserves or production. Second, since the probability of successful exploration is low and there is uncertainty about future market prices, the present value of future depletion deductions from undiscovered wells is substantially lower than from producing properties. Percentage depletion, therefore, tends to encourage the drilling of development wells in known fields more than the explora-

79. *Id.* at 5-6. If these "royalty" payments were not treated as taxes, they would be deducted from gross income (instead of credited against United States income taxes), thereby reducing United States taxes by only 48 cents for each dollar of "royalty." These amounts may also be included in gross income for the purpose of computing percentage depletion, whereas, if they were royalty payments, percentage depletion could not be taken on the foreign governments' shares of gross income.

80. See STAFF OF SENATE COMM. ON INTERIOR AND INSULAR AFFAIRS, *supra* note 75, at 11-20; McDonald, *Distinctive Tax Treatment of Income From Oil and Gas Production*, 10 NATURAL RESOURCES J. 97, 106 (1970).

81. See STAFF OF SENATE COMM. ON INTERIOR AND INSULAR AFFAIRS, *supra* note 75, at 17-20; McDonald, *supra* note 80, at 104-12.

82. See STAFF OF SENATE COMM. ON INTERIOR AND INSULAR AFFAIRS, *supra* note 75, at 25-28; *Hearings on S. 45 Before the Senate Comm. on Interior and Insular Affairs*, 93d Cong., 1st Sess., 40-44 (1973).

83. STAFF OF SENATE COMM. ON FINANCE & HOUSE COMM. ON WAYS AND MEANS, 91ST CONG., 1ST SESS., *TAX REFORM STUDIES AND PROPOSALS*, pt. 4, at 2.2 (Comm. Print 1969) (prepared for the Office of Tax Analysis, U.S. Treasury Dep't).

tion of virgin territories.⁸⁴ Third, to the extent that the supply of oil land is relatively inelastic, percentage depletion merely increases the price of oil lands, redistributing income from the general taxpayer to oil landowners.

Within the petroleum industry itself, the FTC has charged that percentage depletion contributes to vertical integration, concentration, and barriers to entry, particularly at the refinery level.⁸⁵ Firms seek to integrate backward to utilize percentage depletion, thereby increasing vertical integration and concentration in the industry. Vertically integrated firms have incentives to seek higher crude prices in order to concentrate profits at the crude production level where percentage depletion is available. To the large, integrated firm the higher crude prices are merely bookkeeping prices, and the firm may actually increase its net income after taxes by raising crude prices to a point where refinery profits are zero.⁸⁶ Independent refiners, however, are faced with higher real costs and experience decreased total profits. Barriers to entry at the refining level are thereby increased by the ability of the major integrated firms to squeeze the profits of the nonintegrated refiners.⁸⁷ In order to enter the market effectively, a petroleum refiner would have to command sufficient capital and know-how to participate at all stages of production, a requirement likely to eliminate most, if not all, potential entrants.

Considering the scarcity of petroleum, there would appear to be little reason to employ taxes to make oil relatively less expensive than other goods. The appropriate pricing of petroleum is essential to an optimal allocation of resources, and any nonmarket allocation of resources which artificially lowers the price of petroleum will tend to encourage economic waste.⁸⁸ To the extent that the price system does not produce sufficient after-tax return to stimulate investment at the

84. See Davidson, *The Depletion Allowance Revisited*, 10 NATURAL RESOURCES J. 1, 6-7 (1970).

85. PRELIMINARY STAFF REPORT, *supra* note 4, at 16-17, 60-62.

86. *Id.* at 17. The FTC model assumed a perfectly inelastic demand for crude oil and refined products, and related refiner profits linearly to crude prices. The model also assumed a self-sufficiency rate of over 40 percent, a ratio enjoyed by all respondents.

87. It is unlikely that integrated firms would attempt to squeeze the profits of independent refiners to the point where the integrated firm would begin to lose their purchasers of crude.

88. See STAFF OF SENATE COMM. ON INTERIOR AND INSULAR AFFAIRS, *supra* note 75, at 24.

crude producing level (such as for national security requirements), tax incentives may be desirable. However, percentage depletion and the expensing of intangibles are not generally credited with promoting sufficient investment in oil exploration to justify their cost in revenue losses.⁸⁹ On the other hand, they have been widely accused of engendering a misallocation of resources and increased concentration and vertical integration within the petroleum industry.

D. Effect of Governmental Interference in the Market Mechanism

The present structure and conduct of the petroleum industry is very much the product of state and federal governmental policy. The distinctive tax advantages available to the industry, by increasing after tax rates of returns, have attracted capital and labor that would have been more productive in an alternative location. This inflow of resources should have resulted in expanded output and a decline in price. However, to insulate the market price from excess supply, state market demand prorationing has effectively limited domestic supply to the anticipated market demand at prevailing prices. Import restrictions have prevented any external supplies from undermining crude oil prices.

The net effect of this policy has been high prices and over capitalization in oil exploration and production. Society has thereby suffered both a serious misallocation of scarce resources and a redistribution of income away from the general taxpayer and consumer. At the same time it appears that national security, the only justification for incurring these costs, has not been efficiently served by the prevailing policies. Not only has state and federal policy directly restricted supply, but percentage depletion has also encouraged higher crude oil prices in order to concentrate profits at the crude production level. The major vertically integrated firms have been presented, by the government, with both the means and incentive to squeeze the profits of independent refiners.

III. VERTICAL DISSOLUTION IN THE REGULATORY CONTEXT

In its contemplated relief complaint counsel proposes that respondents be divested of 40 percent to 60 percent of their refinery

89. *Id.* at 25-28, 45.

capacity, and that 10 to 13 new firms be established. To insure that the new refinery companies will have access to major pipelines, complaint counsel further proposes divestiture of those pipelines typically owned by the refinery, as well as the transfer to the new companies of fractional ownership shares in connecting joint venture pipelines.⁹⁰ Complaint counsel constructed its contemplated relief on the belief that divestiture will "work to prevent the recurrence of the present shortage of refinery capacity and ensure that the free enterprise system will operate to maintain an adequate economic base for America's future energy needs."⁹¹ Complaint counsel argues that its remedy will reduce refinery concentration and respondents' alleged monopoly power. Second, it will reduce entry barriers by giving new firms access to pipelines on terms equal with respondents,⁹² and by making respondents net sellers of crude oil and net buyers of gasoline. Complaint counsel concludes that respondents will then have little incentive to affect independent refiners' profits adversely, permitting satisfactory returns and entry at both the refining and marketing levels.⁹³

As complaint counsel has argued, the proposed remedy will decrease concentration at the refinery level, as well as dilute pipeline ownership and make respondents net sellers of crude and net purchasers of gasoline. However, the more fundamental question remains: will society tend to benefit from such a restructuring,⁹⁴ or will present federal and state interference in the market mechanism foreclose any meaningful benefits that might otherwise accrue from restructuring the petroleum industry?

Crucial to respondents' alleged control over the refinery level (and resulting strength at the market level) has been the govern-

90. See Prediscovery Statement, *supra* note 3, at 137-41. Complaint counsel also proposes several additional remedial measures, including a ban against future refinery acquisitions, and limits on joint ventures, processing arrangements and crude oil and product exchanges.

91. *Id.* at 141.

92. The FTC argues that, despite regulation by the ICC, pipelines can be employed as barriers to entry by "(1) requiring shipments of minimum size (2) granting independents irregular shipping dates, (3) limiting available storage at the pipeline terminal, (4) imposing unreasonable product standards upon independent customers of pipelines, and (5) employing other harassing or delaying tactics." PRELIMINARY STAFF REPORT, *supra* note 4, at 26.

93. Prediscovery Statement, *supra* note 3, at 139.

94. As has already been argued, since the Federal Trade Commission Act is prophylactic rather than punitive, societal welfare should be a major, if not the principal consideration in formulating a remedy. See note 8 *supra*.

mentally maintained control of crude supplies. Coupled with percentage depletion, which has encouraged integrated firms to increase after-tax net income by increasing crude prices and concentrating profits at the crude production level, significant entry barriers have been established.⁹⁵ One of the purposes of decreasing entry barriers is to permit excessive profits to attract investment into that industry in order to increase supply and lower prices until excessive profits are eliminated. Even if excessive profits are being earned currently at the refinery level,⁹⁶ no resulting increase of refinery products can occur so long as crude oil supplies are restricted. The inability of potential entrants to secure sufficient supplies will limit entry,⁹⁷ and even if additional investments should enter, without a resulting increase in production, a misallocation of resources will occur. It therefore appears that as long as market demand prorationing will be able to limit the future supply of crude oil produced to anticipated demand at market price⁹⁸ entry into the refinery level will be limited. If exces-

95. For FTC awareness of institutionally created entry barriers see PRELIMINARY STAFF REPORT, *supra* note 4, at 25-27.

96. It is not clear whether excessive profits are being earned. In its preliminary report the FTC stated that:

The petroleum industry, and refining in particular, is also characterized by high barriers to entry. Without such barriers, excess profits would attract new firms into the market, increasing the supply, and eliminating the excess profits,

PRELIMINARY STAFF REPORT, *supra* note 4, at 25. Referring to respondents, complaint counsel charges that the "economic rate of return, as distinct from their accounting rate of return, for refinery operations is above the competitive rate of return." Pre-discovery Statement, *supra* note 3, at 91. Yet, complaint counsel also alleges that "[r]espondents have established and maintained artificially high prices of crude oil, resulting in artificially high profits in crude production and artificially low profits at other levels of the industry." *Id.* at 93. The Treasury Department has argued that refinery profits currently rank rather low compared to all manufacturing corporations. See STAFF OF THE COMM. ON INTERIOR AND INSULAR AFFAIRS, 93D CONG., 1ST SESS., DEPARTMENT OF THE TREASURY STAFF ANALYSIS OF THE PRELIMINARY FEDERAL TRADE COMMISSION STAFF REPORT ON ITS INVESTIGATION OF THE PETROLEUM INDUSTRY, JULY 2, 1973, at 30-33 (Comm. Print 1973). The absence of excessive profits would seem consistent with percentage depletion which would tend to encourage the concentration of profits at the crude production level at the expense of the refining level. Nor does it appear likely that partial divestiture at the refining level would tend to shift profits back to that level so long as percentage depletion encourages higher crude prices and the supply of crude may be administratively restricted to support such prices.

97. As refineries near capacity operation, sharply declining average costs make operation below capacity, due to the unavailability of crude, less profitable since output is below the level that would minimize average costs. See PRELIMINARY STAFF REPORT, *supra* note 4, at 26.

98. The FTC acknowledges that the past ability of the major firms to turn to governmental entities to limit excess supply implies a high probability of future success. *Id.*

sive profits are not being earned at the refinery level,⁹⁹ significant entry is also not likely to occur. Nor is deconcentration alone likely to lead to increased supply or lower prices, as long as supply is limited to anticipated market demand at prevailing prices.

More importantly, even if there is entry into the refining level, or merely deconcentration of that level by divestiture, it is questionable whether, in the long run, there will occur permanent and ameliorative structural or behavioral modifications. As long as governmental regulatory policies enable and encourage concentration of profits at the crude levels, the large vertically integrated firms may still find it advantageous to maintain low bookkeeping profits at the refining level. Respondents, who are to be divested of only approximately half their refining capacity, may be able to undersell their nonintegrated competitors, since the shifting of their profits to the crude level, and the higher after tax rate of return earned at that level, may compensate for lower profits at their remaining refineries. Since complaint counsel only seeks to prohibit acquisitions at the refinery level, respondents may be able to regain dominance at that level through internal expansion. The newly created independent refiners may therefore also seek to integrate backwards to enjoy the special tax provisions available at that level. As long as incentives for recombination through vertical integration remain, divestiture may even decrease the number of independents at the crude and marketing levels by increasing the number of vertically integrated firms.¹⁰⁰

In the short run, independent marketers are likely to benefit most from complaint counsel's proposed remedy since they will have equal access, through competitive bidding, to any increased output of gasoline that will be available from independent refiners. While this may permit consumers to choose more low priced gasoline without amenities, the price of gasoline itself is not likely to vary substantially from the price supported by controlling the availability of crude oil.

Although industry conduct may have contributed to entry barriers at the refinery level, the most significant and least permeable barriers have been those erected and maintained by governmental policies. It follows that prerequisite to any antitrust action which

99. See note 96 *supra*.

100. Of course, should this structure evolve, while the number of independent firms might be reduced, the increased number of vertically integrated firms would increase competitive pressures within the industry.

seeks an ameliorative restructuring of the petroleum industry is the restructuring of governmental intervention in the market mechanism.

CONCLUSION

If divestiture is to be pursued meaningfully, Congress should first, reevaluate the special tax provisions available to the petroleum industry, particularly percentage depletion.¹⁰¹ If the market price system is not producing sufficient after tax returns to stimulate investment in oil production (to meet national security requirements), only those tax incentives which effectively encourage exploration and production (or development of new sources) should be considered. Second, state market demand prorationing should be reexamined in light of the significant economic waste it promotes. To the extent that governmental intervention in the market is necessary to compensate for the "rule of capture," unitization appears to be an alternative consonant with both economic conservation and competitive behavior. Third, restrictions of foreign oil imports are only justified by national security requirements. The determination of the type and extent of any restrictions should balance the costs and benefits of alternative programs. A program which minimizes social costs and maximizes domestic competition, consistent with national security requirements, should be favored. Over the long run, a system of tariffs appears more consistent with these objectives than import quotas.

Without meaningful changes in present governmental regulation of the petroleum industry, it appears unlikely that divestiture will sufficiently benefit society to justify the considerable costs of litigation, reorganization, possible diseconomies of scale of vertical dissolution, and the general uncertainty which will inevitably accompany so profound an administrative restructuring of a major American industry.

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101. Congress repealed the oil depletion allowance for major producers on March 26, 1975. However, income from the first 2000 barrels a day of production (to be lowered to 1000 barrels a day by 1980) by producers who have no retail outlets and no more than one small refinery will still be eligible for the 22 percent allowance (to be reduced to 15 percent by 1984). The bill also strictly limits the use of foreign tax credits from foreign oil extraction income and foreign oil-related income. *N.Y. Times*, March 27, 1975, at 51, col. 5. This legislation removes an inefficient method of stimulating production as well as one of the major institutional incentives for vertical integration in the petroleum industry.